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ABSTRACT

School-finance reform is an issue that has been on New York State's agenda almost continuously since the 1960s. Information that is intended to make basic school-aid issues understandable to the average citizen is provided in this report. The report focuses on the existing finance system, the equity issues, and the options for reform. The paper is presented in three sections. Section 1 provides a general background on school fiance, describing how schools are funded, how state aid is distributed, and what the essential equity issue is. The narrative is issue-oriented, intentionally avoiding descriptions of the calculations behind aid distribution. Section 2 describes long-term trends and recent developments in school finance. The section includes a description of spending trends, changes in aid distribution, the 1993-94 reforms and their implementation, and a discussion of the "modified freeze" in the school-aid formulas. Section 3 outlines alternatives for reform of the finance system and explores some of the reasons why such a long-standing issue is still unresolved. It is suggested that the discussion of the reform options identifies the essential issues that must be resolved for a long-term solution to be reached. An appendix provides a statistical supplement to the report. (RJM)

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School Finance Reform

— A Discussion Paper —

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State Comptroller

October 1995

State of New York
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EA 029 036

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October 1995

To the People of the State of New York:

School finance reform is an issue that has been on New York State's agenda almost continuously since the 1960's. Court cases have been brought, a multitude of studies have been done, and commissions and task forces have reported, yet we are still very far from a satisfactory solution.

All too often, school finance is discussed in a technical jargon related to formula components, "shares" and other arcane points in the distribution of aid. The presentation of the topic in this manner hinders public understanding and the larger picture is often lost in the details. This discussion paper describes in plain language the existing finance system and the options for reform. It is designed to stimulate discussion of the problem, but it does not endorse a particular solution. No reform will be achievable unless a broad consensus exists behind it, and this paper is designed to assist in the process of arriving at such a consensus.

The budget gaps looming for the State reinforce the reality that resources will be limited in the near term. This means that the school finance issue must be addressed without any big increases in state funding. Nevertheless, a solution must be sought, whether through altering the aid distribution or through more fundamental changes to the school finance system. Reform of the present real property tax system must also be pursued.

But ignoring the issue, which was essentially what was done in this year's budget, will not solve the problem. Holding to the status quo is really a step backwards in achieving equity.

Improving the educational system is vital to enhancing our economic and financial condition and no one's interests are well-served in the long run by failing to address this issue.

Sincerely,

Carl McCall

H. Carl McCall
State Comptroller

CONTENTS:

Introduction 1

Basic School Finance Background 2

How Schools are Funded 2

Lottery Revenues 3

How State Aid is Distributed 3

The Reform Issue 6

Long-Term Trends and Recent Developments 8

Major Trends in School Finance 8

Categorical Aids 8
Wealth Measures 9
Deficit Reduction Assessments 9
1993-94 Reforms 10

Spending Disparity Trends 11

School Aid Provisions in the 1995-96 Budget 13

Alternatives for Reform 16

Policy Options 16

Leveling Up 16
Redistribution 17
Alternative Local Revenue Sources 18
Sharing Property Tax Revenues 19

Summary 20

Appendix — Statistical Supplement 21

Introduction

This paper provides background on the basic school aid issues in an accessible format and length. It describes in plain language the existing finance system, the equity issue and the options for reform. It is designed to stimulate and facilitate discussion, not to endorse a particular solution.

The paper is presented in three sections. The first section provides a general background on school finance, describing how schools are funded, how state aid is distributed, and what the essential equity issue is. The narrative is issue-oriented, intentionally avoiding a description of the algebra behind the aid distribution. Detailed knowledge of the mechanics is not necessary to a thorough understanding of the issues, and too technical a focus can often obscure the larger concerns.

A second section describes long-term trends and recent developments in school finance. It includes a description of spending trends, changes in the aid distribution, the 1993-94 reforms and their implementation. This year's "modified freeze" in the school aid formulas is reviewed, including its negative impact on equity.

The third section describes alternatives for reform of the finance system. It also explores some of the reasons why such a long-standing issue is still unresolved. The discussion of the reform options identifies the essential issues which must be resolved for a long-term solution to be reached.

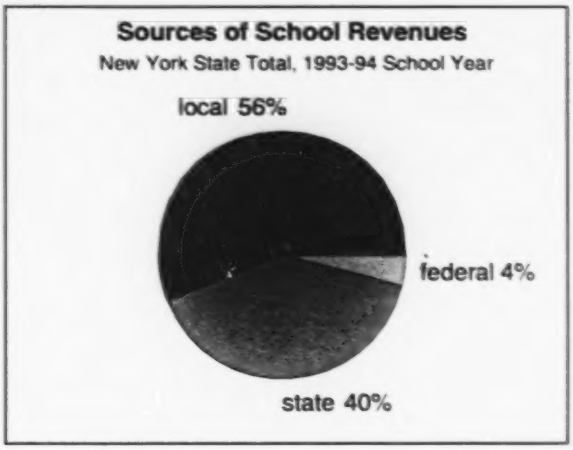
An appendix provides a statistical supplement to the report. It includes a presentation of some of the data summarized in charts in the first three sections and a statistical profile of various types of school districts. The appendix also provides a selected bibliography.

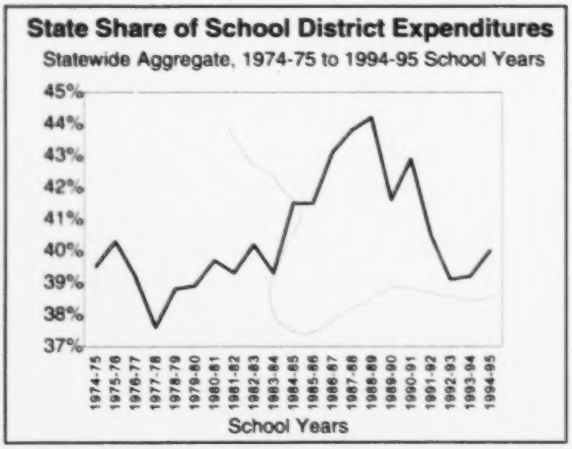
Basic School Finance Background

How Schools are Funded

In New York, as in most other states, public elementary and secondary education is provided through local school districts and supported by a mix of local, state and federal revenues. The primary source of local revenues for schools is the property tax.

More than $25 billion is now spent annually in school districts across the State, of which there are nearly 700. Recent data show that about 56 percent of school revenue comes from local sources, state aid provides 40 percent, and federal aid about 4 percent. The local portion of school revenues is primarily from the property tax (90 percent). In addition to property taxes, in some counties school districts receive a portion of sales tax receipts and some small city school districts impose consumer utility taxes. The federal government is not a significant source of revenues for most school districts.





The state share of education expenditures in New York is influenced both by state aid levels and by trends in local spending. Roughly speaking, it has been in the neighborhood of 40 percent since the 1950's, going up in good times and tending to drop during periods of state fiscal difficulty. A state share of 40 percent is lower than the national average, which is approximately 46 percent in the 1993-94 school year. Advocacy groups have long called for a higher state share, often saying that 50 percent is appropriate. An increase in the state share to 50 percent, however, would require about $3 billion in additional state aid — an unlikely event in the current fiscal environment.

Note that the state share discussed here is the aggregate share for the entire state — the share varies considerably across districts. Some schools receive a much higher percentage of their revenues from the state (generally, these are low-wealth, low-spending districts) and others support nearly all of their expenditures from local sources (generally high-wealth, high-spending districts).

Lottery Revenues

Much confusion exists over the use of state lottery revenues for education. The lottery began in 1967 following passage of an amendment to the state constitution permitting a lottery, the net proceeds of which were to support of education. Of the total receipts from game sales last year, 41 percent went to education, 48 percent was paid out in prizes, and 11 percent went to administration.

The lottery proceeds do go to education, currently providing more than $1 billion annually to help support state aid, representing about one-tenth of total state aid payments. Lottery proceeds, however, do not really go to school districts in amounts over and above the State's contribution through general aid programs. Each year, the Governor and Legislature negotiate a state aid distribution. While lottery proceeds do help to fund each year's aid package, lottery earnings are not added to a planned general fund contribution after the fact. The estimates for lottery earnings, in fact, are treated almost exactly as the estimates for the earnings of other state revenue sources.

This year, for example, the Governor proposed implementing a new "Quick Draw" lottery game and the Legislature accepted this proposal, with some modifications. From the beginning, the addition of the new lottery game was discussed as a way to help close the overall budget gap, not as an issue related to the amount of school aid that would be provided. The Quick Draw game as proposed by the Governor was expected to raise $115 million initially, yet his budget proposal reduced school aid by $90 million for the 1995-96 school year. The enacted budget, largely because of a later starting date, reduced the estimate for the first year's Quick Draw earnings, but increased school aid. Clearly there was no linkage between the new game's earnings and school aid payments.

It should be noted, however, that the availability of lottery proceeds over the years may have allowed increases in school aid that otherwise may not have been available.

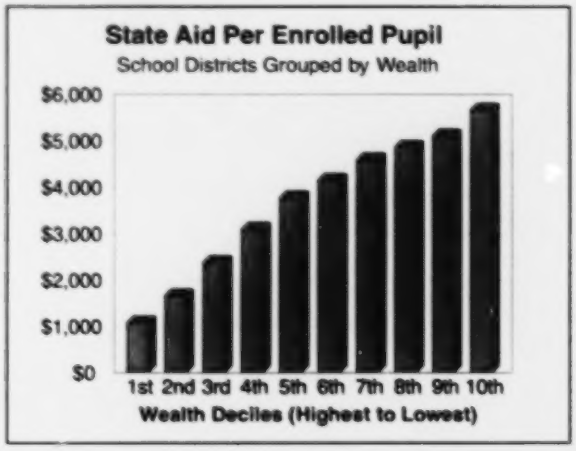
How State Aid is Distributed

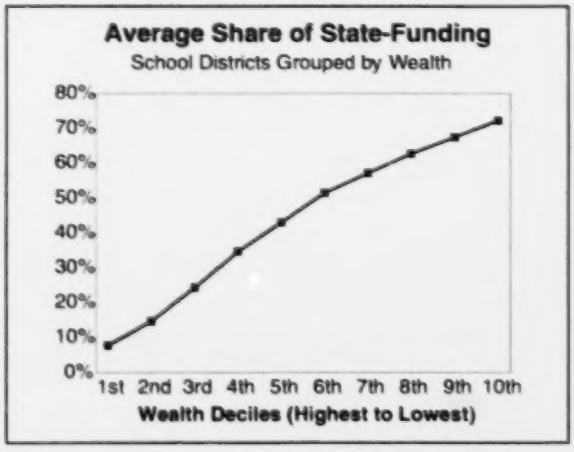
Nearly $10 billion in state aid is apportioned among local school districts through a variety of aid formulas and grant programs. Each year the aid programs are modified in the budget. While the mechanics behind the distribution of school aid are fairly complex, the issues are not necessarily so. For example, there are currently some 46 aid formulas and grant programs and only a small group of school aid specialists have an in-depth understanding of those aid categories and the algebra behind the formulas. However, a technical understanding is not necessary to grasp the essential issues.

The vast majority of state school aid is paid through aid formulas that are designed to recognize local need. Relative need in the formulas is generally determined by district wealth and expressed as an aid ratio, but myriad other factors are built in. These other factors include special pupil counts representing educational needs; overall operating expenditures as well as specific expenditures in areas such as building, transportation and handicapped education; and measures of tax effort. Most aid formulas pay aid on a "per pupil" basis — an aid amount is multiplied by a pupil count to determine total aid. In addition to the formula distributions, there are a number of grant programs where aid payments are either legislatively determined or allocated through an application process, but these programs represent only a small proportion of overall aid.

School aid formulas generally pay aid in inverse proportion to wealth. The formulas measure "wealth" based on property value per pupil and resident income per pupil. Pupil counts are based on average daily attendance and contain differential weightings for certain categories of students. The amount of state aid a district receives is in large part determined by the ratio of property and income wealth measures for the district to the state average. The most commonly used ratio, based half on property wealth and half on income, is referred to as the "combined wealth ratio."

The chart at right illustrates the fact that higher aid payments go to school districts as their relative wealth decreases. State aid per pupil is lowest for the highest wealth districts (the first decile). Lower wealth school districts receive proportionally more aid per pupil. The payment of aid in inverse proportion to wealth is often referred to as an "equalized" aid distribution.





The increasing aid paid to lower-wealth districts results in a generally higher state share for expenditures in lower-wealth areas, as illustrated by the chart at left. This trend is accentuated because lower-wealth districts tend to spend at lower levels, measured on a per pupil basis. The disparity in expenditure levels is at the heart of the equity issue.

Each wealth "decile" shown in the charts represents a tenth of the State's school districts grouped by wealth (the combined wealth ratio). Although each decile contains a tenth of the school districts, the number of pupils within a

decile varies widely. For example, the 4th wealth decile contains 45 percent of statewide enrollment, largely because it includes the New York City school system.

With a few exceptions, most of the aid formulas provide aid on an equalized basis, meaning that poorer districts receive a higher relative share of aid. There are, however, other factors involved in the distribution of aid which limit the amount of equalization provided, including minimum aid grants, "save-harmless" provisions and "caps."

Save-harmless provisions prevent districts from receiving less aid from year to year even though they may have fewer pupils, lower expenses, higher wealth, or any other change in underlying conditions which would cause them to receive less aid. The chief save-harmless provision in the current aid formulas is contained within the "transition adjustment" which ensures that no district receives lower aid across nine aid formulas than in the previous year. The transition adjustment also caps aid, limiting the increase which each school district can receive. Minimum aid guarantees, save-harmless provisions and caps all decrease the equalization the formulas would otherwise provide.

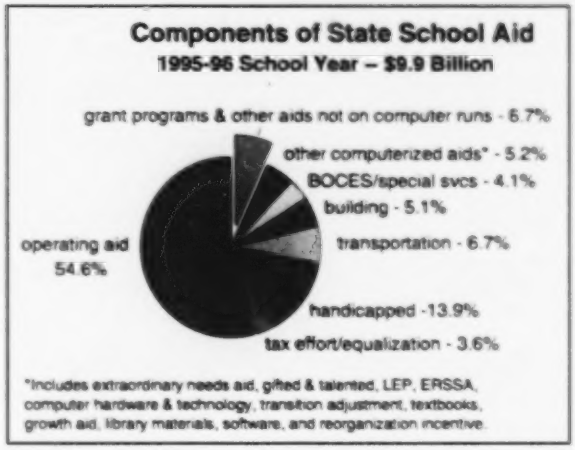
"Operating aid" is the largest aid formula, representing slightly more than half of total aid. This formula provides general aid to districts for their expenses through an aid ratio based on property and income wealth. The formula delivers a higher share of aid for lower wealth districts; it also contains a minimum aid amount (the "flat grant"), and a number of limits, exceptions and other provisions. A related "extraordinary needs" component of aid distributes general aid based upon income wealth and a number of factors intended to measure the proportion of disadvantaged pupils within a district.

Two other general aid formulas specifically address local tax effort. These formulas are based on tax levies, spending and wealth and, among other things, are designed to help districts with limited resources located in high-expense regions of the State.

Most of the remaining school aid formulas are linked to particular activities such as transportation, building, or handicapped education. Again, most of these formulas employ an aid ratio based on a district's relative wealth, so that lower-wealth districts receive proportionally higher shares of aid. Some aid formulas do not reflect relative need, but these only represent a small component of aid. Textbook aid, for example, is paid to all districts on the basis of a flat dollar amount per pupil; other formulas, such as those for computer software and library materials are similar in nature.

There are also a number of grant programs and aid categories in which legislatively specified amounts go to particular districts. These aid programs are generally not related on a formula basis to wealth or need. A large proportion of these programs, however, do aid areas presumed to be needy, the large city school districts in particular.

Sometimes a distinction is drawn between the "computer run total" and other aid. More than 90 percent of state aid is shown on State Education Department computer runs. Sometimes manipulations occur in this regard. This year, for example, Excellence in Teaching aid was not shown on computer runs, and thus its elimination did not show as a loss for districts. While the "non-computerized" grant programs and aid formulas do not represent a large proportion of total aid, they are significant for some districts, particularly the large city school districts.


Components of State School Aid
1995-96 School Year – $9.9 Billion
grant programs & other aids not on computer runs - 6.7%
other computerized aids* - 5.2%
BOCES/special svcs - 4.1%
building - 5.1%
transportation - 6.7%
operating aid
54.6%
handicapped -13.9%
tax effort/equalization - 3.6%
*Includes extraordinary needs aid, gifted & talented, LEP, ERSSA, computer hardware & technology, transition adjustment, textbooks, growth aid, library materials, software, and reorganization incentive.

The Reform Issue

Despite the school aid formulas' equalizing impact, educational spending varies significantly with local wealth. Wealthier districts spend at much higher levels than poor school districts.

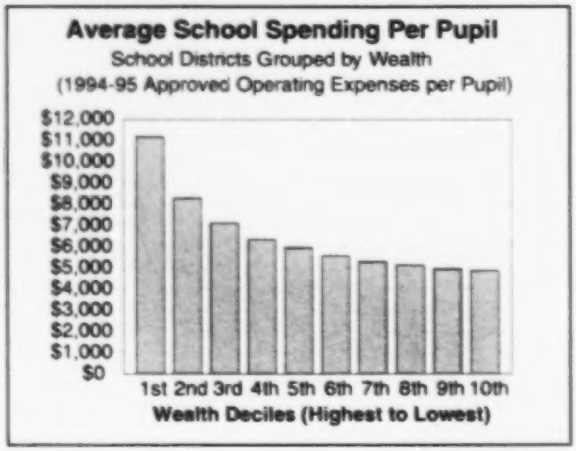
Local property taxes pay for the majority of public school expenses. Property wealth, as well as income with which to pay property taxes, is not evenly distributed among school districts. Great disparities in spending, and thus in educational programs, are largely a function of variations in the local property tax base available to finance education.

Although state aid is generally paid in inverse proportion to wealth, the aid payments are not high enough in the low-wealth areas to effectively allow them to spend in amounts similar to wealthier districts. Thus, while state aid is redistributive, it is not enough so to effectively equalize opportunity.

The property tax is regressive and often inequitably administered. Reducing reliance on it as a revenue source is therefore attractive on its own merits, beyond the issue of equalizing school spending. Although property tax reform is not a subject of this discussion, it should be noted that improvements in administration of the tax are possible. To a large extent, property tax inequities and inaccuracies are the result of its administration through more than 900 localities — a regional assessment model may be much more effective.

Property taxes can also be made less regressive through state income tax "circuit breaker" programs which provide a tax credit for lower-income persons carrying a high property tax burden; New York State has such a program, but it currently operates at a very low level.

The chart to the right shows the clear relationship between wealth and spending. The amounts shown are averages for groups of districts ordered by relative wealth. While on average the wealthiest tenth of districts (the 1st decile) spends more than $11,000 per pupil annually, the poorest tenth spends less than $5,000. Wealth-driven disparities in spending and programs is the central issue of school finance reform.



It is not generally argued that there should be *no* spending variances among schools, because New York State has a strong tradition of local control of education. The argument is more that the spending variances should be less stark and that the lower-wealth areas should receive more help so that they can improve their educational programs.

Spending differences reflect both differing preferences among school districts and also differing fiscal capacities. However, the extent to which they represent one or the other is extremely hard to isolate. A relatively greater disposition to commit resources to education tends to be found in areas with relatively greater resources to commit. Regional cost differences also affect spending levels and some areas face higher costs due to relatively greater concentrations of disadvantaged students.

One critical issue is whether the spending disparities result in students in the poorer districts receiving less than a sound basic education. This was the element on which the most recent major New York State school finance case turned. In the 1982 *Levittown* decision the Court of Appeals found that the school finance system did not violate the state constitution's education provisions because those provisions required only that "minimally acceptable schools" be provided.

A current school finance case, *Campaign for Fiscal Equity vs. State of New York*, is similar to the earlier case but also includes claims based on the federal Civil Rights Act. In a preliminary ruling allowing the case to go forward, the Court of Appeals stated that, while the 1982 *Levittown* decision held that moderate variation in funding levels was tolerable, it was possible that the variation has become so extreme as to permit judicial intervention. As in the previous case, however, the Court did not specify what is meant by "minimally acceptable schools." It is difficult to guess what the outcome of this case will be, but it will, in any event, probably take many years at trial and in appeals. As a reference point, the *Levittown* case was in the courts for eight years before final resolution.

Long-Term Trends and Recent Developments

Major Trends in School Finance

While aid amounts have gone up in nominal terms, and the state share of expenditures has gone up and down, the essential issues remain the same as they were 20 years ago. The inequity of the heavy reliance on the property tax, the spending disparities and the gap between the wealthy and poor school districts are still the key issues. Much has also changed, however, and the state aid formula has gotten much, much more complex.

In 1974-75, there were only three major categories of aid for school districts: operating, building and transportation. The algebra behind the formula was simple enough that the State Education Department put out a small booklet with the intent of explaining it to the public.

There are now some 46 formulas and grant programs that comprise state aid, and the esoteric methods behind the formula distribution have become almost entirely the province of school finance specialists. Previously described as an "elegant formula," the distribution mechanics now involve a complex amalgamation of formula factors, many of which bear no rational relationship to any describable state aid goal. The computer run distribution of aid and the "shares" issue are the major focal points of the annual school aid negotiations.

This is not to suggest that all the changes have been negative. The formulas now provide significant aid for handicapped education programs, for students with special needs and for school districts with a greater proportion of disadvantaged students. The following discussion provides an overview of some of the major trends in school finance in the past two decades.

Categorical Aids

Aid programs directed to particular needs are sometimes referred to as "categorical" aids, as distinct from aid programs supporting general operating expenses. The growth of these categorical aids during the last decade was phenomenal. For example, there are now specific formulas for gifted and talented pupils, limited English proficiency programs (LEP), educationally related support services aid (ERSSA), computer hardware and technology, library materials, and many, many more.

The rapid expansion of categorical aids, primarily occurring in the early 1980's, was driven not only by a legitimate concern for programs in these areas, but also by distributional concerns. The continuing addition of new categorical aid programs allowed *all* districts to get aid increases, even "save-harmless" districts that would otherwise have gotten no increases during those years. Although most of the categorical formulas employ aid ratios, they also have minimum aid provisions and so, in most cases, each time a new formula was added, even the wealthiest districts got additional funding. Program advocates for particular types of education also supported the new aid categories,

and announcing a new aid program was more attractive than merely saying that more money was being provided for schools.

Wealth Measures

Another big change has been in the area of wealth measures. In 1974-75, only property wealth was considered in the aid formula. In the early 1980's, income began to be used in the aid distribution. It was first used in a small supplementary formula, but its use continued to be expanded and today income and property wealth are of approximately equal importance in the state aid distribution.

The use of income in the formula was initially spurred by frustration with the quality of the property wealth data and by academic research suggesting that income levels were an important determinant of educational spending. Perhaps the most important consideration behind the legislative expansion of income in the formula, however, was the *distribution* its use in the aid formulas provided.

Interestingly, all of the research on income was based on household income or other measures approximating average income levels. The income measure employed in the formula, however, has always been income *per pupil*. Income per pupil measures not only the income levels within a community, but also the relative concentration of households with children in the public schools as a share of the total income-earning population. While urban areas often have lower average income levels, they have large portions of the population without school-age children or that utilize private schools; income per pupil measures are therefore less favorable to them as a wealth measure, because they show them as being relatively wealthier and consequently reduce aid. Conversely, many suburban areas with higher average incomes actually benefit from the use of income per pupil, because their relatively higher share of public school children skews the measure, making them seem less wealthy and increasing their aid.

The frustrations with the property value data stem from inaccurate assessment practices and their effect on the "full value" data calculated using equalization rates and applied in the aid formulas. Improvements have been made in the full value data since the time income was introduced in the formula, particularly a reduction of the lag in the market survey data used to establish full value. However, the quality of the data is still a major issue as are inaccurate assessment practices.

Deficit Reduction Assessments

The State's fiscal crisis in the early 1990's led to the so-called deficit reduction assessments, or DRA's. Essentially, these assessments were reductions in aid determined by a formula approach and reducing the aid payments received through the regular formulas. The first DRA was applied in the middle of a school year, in reaction to the State's midyear budget crisis, giving school districts their own considerable midyear budget problems.

Despite their unpopular nature, it should be noted that the DRA's had the overall effect of making school aid payments more equalized. The reductions were made on the basis of formulas which more heavily impacted wealthier districts and districts which had benefited from save-harmless for a number of years; the long-term effect was to lower the proportion of school aid paid through save-harmless. The DRA's were in effect for the 1990-91 through 1992-93 school years. Before their elimination with the 1993-94 school aid reforms, the DRA's reduced overall state aid by more than $1 billion.

1993-94 Reforms

The 1993-94 budget contained a series of formula changes and some consolidations, patterned after the recommendations in the 1988 report of the Salerno Commission, a special task force that studied school aid. The Salerno Commission's recommendations were general in nature; they endorsed a series of principles rather than attempting to agree on a single formula. In so doing they avoided the experience of an earlier task force associated with the *Levittown* case, which could not agree on a single formula.

The formula changes adopted in 1993-94 were announced as the most sweeping reforms in more than a decade. However, it is arguable whether one of the major goals of the 1993-94 changes, simplification of the formula, was in fact achieved. Some small categorical aids and some supplemental operating aid formula distributions were merged into operating aid proper, but the operating aid formula itself became much more complex. Following the Salerno Commission's recommendations, the 1993-94 formula changes did more heavily reflect the costs of educating at risk students and they also incorporated actual spending levels and tax rates more significantly in the formula, in recognition of differences in regional costs.

The 1993-94 formula changes, however, did not initially result in a significant redistribution of aid and they have never been fully funded. The formula changes were accompanied by a "transition adjustment" covering nine formulas and providing both save-harmless protection against losses in aid and also limits or caps in aid increases. The transition adjustment has also been referred to as a "collar" because it can both govern increases and prevent (or limit) decreases.

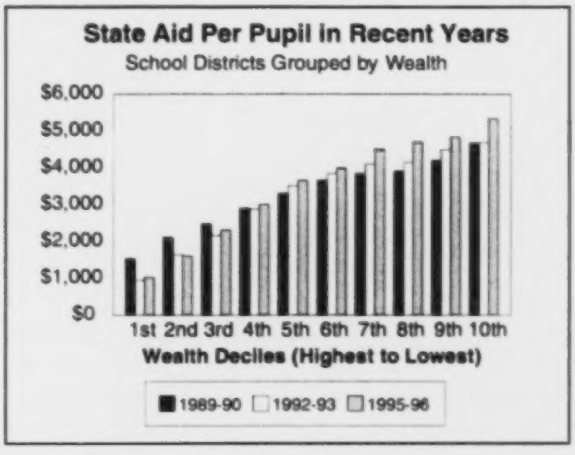
The caps in aid increases were helpful in achieving the 1993-94 reforms, as the State could not have afforded immediate implementation of the new formula. It should be noted, however, that the reinstatement of caps in formula aid reversed a reform accomplished in the previous decade. Increases in operating aid were routinely capped in the 1980's. The caps limited equalization by preventing lower-wealth districts from receiving their full formula aid and their elimination was a considerable reform.

In the 1993-94 school year, the first year of the revised formula, the increases were limited to 3 percent, with a further adjustment for enrollment growth. The major formula changes therefore had little effect, and for most school districts aid was determined by the transition adjustment; they

either got the growth adjusted 3 percent increase or no change in aid. The underlying formula changes had the potential to dramatically redistribute funding, but did not do so initially.

In 1994-95, fueled by a budget surplus, a $550 million increase in school aid was provided and the transition cap was loosened to allow aid increases of up to 6.85 percent. The changes allowed the formula to operate more freely and improved equalization under the aid formula. This movement forward in equalization, however, came to a halt with the 1995-96 budget and its freeze of the aid formulas.

To complete the phase-in of the 1993-94 formula reforms in 1995-96 would have required about $500 million beyond what was allocated, on a school year basis. (A precise, objective estimate of what full funding would cost is prevented by interim formula changes, including new lags built into the aid calculation.)



The combination of the deficit reduction assessments and the 1993-94 reforms (to the extent they have been allowed to phase in) has been to produce a more equalized aid distribution. The chart at left graphically portrays this improvement. For school districts in the first three (highest wealth) deciles, state aid per pupil has been reduced since 1989-90. For districts above those wealth levels aid has been increased, most dramatically for districts in the lower wealth deciles.

Note: for comparability purposes, the data in this chart represent computerized aid per total aidable pupil unit and thus do not match the data for 1995-96 state aid per enrolled pupil shown earlier.

Spending Disparity Trends

A central tenet in the case for reform is that the spending disparities among school districts, largely driven by wealth, are simply too great. There is, however, no generally accepted single method of measuring the disparity. A variety of statistical approaches are possible, ranging from complex correlation procedures to simply comparing the highest spending district to the lowest. Despite these problems, it is important to consider the broad trends in spending variations.

The State Education Department annually publishes statistics on school district spending showing the variances among districts on a per pupil basis. Included in their statistics is the

difference between districts at the 10th and 90th percentiles of spending. As this difference in spending expressed in a dollar amount would increase over time with inflation, even with no real change in the level of disparity, their statistics include the difference shown as a percentage of the spending level at the 10th percentile.

Distribution of School District Spending

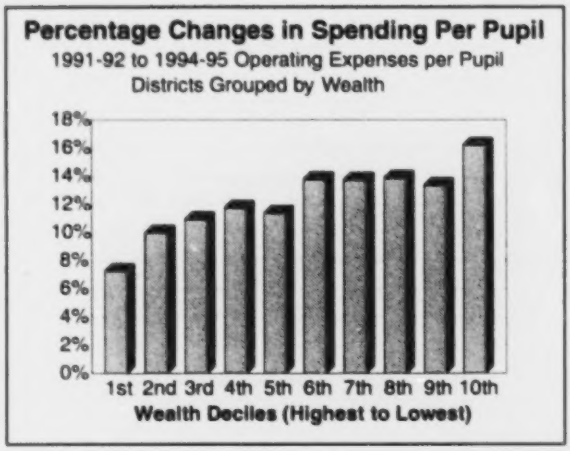
School Year	10th Percentile	Median	90th Percentile	Difference: 10th to 90th	As a % of 10th
1994-95*	$4,650	$5,692	$9,268	$4,618	99.3%
1993-94*	4,445	5,413	8,878	4,433	99.7
1992-93	4,224	5,187	8,626	4,402	104.2
1989-90	3,953	4,740	8,218	4,265	107.9
1984-85	2,482	2,989	5,211	2,729	110.0
1979-80	1,641	1,956	3,163	1,522	92.7
1974-75	1,067	1,274	2,013	946	88.7

Source: State Education Department, "Analysis of School Finances in New York State School Districts, 1992-93. *Data for 1993-94 and 1994-95 are preliminary, based upon State Education Department data provided to the Comptroller's Office and analyzed for this report.

The data indicate a widening disparity since 1974-75, the year the *Levittown* case was brought. However, a reduction in the spending disparity has occurred since the mid-1980's. It is interesting to note that the expenditure disparities were widening in the first half of the 1980's during a period when state aid was being greatly increased and the aggregate state share of expenditures was generally increasing. As noted earlier, this was also a period during which a great number of categorical aids were added, the distribution of which was, to certain extent, disequalizing.

More recent data from the Education Department, not yet summarized in their publications, suggests that the pattern of slightly decreased expenditure variations is continuing. Data available for the 1993-94 and 1994-95 school years, although preliminary, shows the relative variation in school district spending between the 10th and 90th percentiles to have dropped below 100 percent. Other statistical measurements show similar results. This reduction in the expenditure variations since the late 1980's may be caused in part by the improved equalization in the aid distribution. An analysis of changes in average spending levels among school districts grouped by wealth tends to support such a theory.

The chart to the right shows that, on average, lower-wealth districts per-pupil expenditures have increased by a higher percentage than those of higher-wealth school districts during the period from 1991-92 to 1994-95. Data for 1994-95 is still preliminary, however, and caution should be used in interpreting these statistics. Nonetheless, it appears that slight reductions in wealth-related spending disparities have occurred. It is important to note that these figures are based on the formula distribution and district expenditure changes *before* the current school year, when a modified freeze of aid was enacted. That freeze may have eroded the apparent recent improvements in equity.



School Aid Provisions in the 1995-96 Budget

The "modified freeze" of the school aid formulas in this year's budget reduced equity in the finance system.

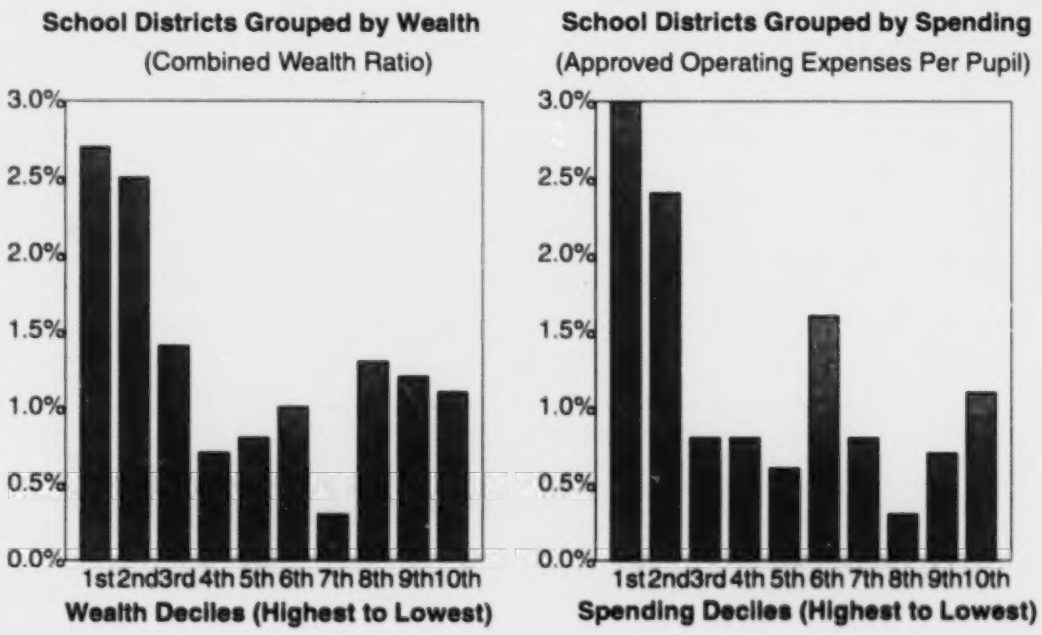
Failing to address equity in the state aid distribution, even in a single year, may be thought of as standing still. However, as local school districts face growing expenses, the poorer districts are less able to address these needs. Stasis in the aid distribution as expenses grow therefore has the effect of actually reducing equity.

Most school aid formulas were frozen for the 1995-96 school year, with the exceptions being changes allowed in several expense-driven formulas, adjustments for districts with growing enrollments and other changes in various grant programs. The freeze of the formulas undercut the corrective distribution originally intended. Aid increases went to districts with increasing enrollments or growing expenses in certain areas, and thus were not in any way targeted to equity or wealth-related need.

In fact, the results of the modified freeze have been somewhat perverse: *higher-wealth and higher-spending districts have done proportionately better than lower-wealth, lower-spending districts*. This situation is shown in the two charts on the following page. When ranked by both wealth and spending, the highest-wealth and highest-spending districts received the largest percentage increase in aid. This step backwards in equity is of particular concern given that a court challenge to the educational finance system is under way.

1995-96 School Year Percentage Aid Increase

The consequences of a "modified freeze" -- the highest wealth and highest spending school districts receive proportionally larger increases



This year's enacted budget increased school aid by $68 million in the 1995-96 school year, an increase of just slightly over one-half of one percent. In comparison, the average annual increase in school aid over the previous ten years has been six percent.

The 1995-96 school year aid increase is also far below what the previous year's statutory formulas would have provided. This situation results in large part because the changes made several years ago in the school aid formulas are still phasing in through the transition adjustment. Many needy districts would have had significant increases in the 1995-96 school year if the school aid statutes had not been altered in the budget legislation.

In 1995-96, the transition adjustment simply freezes aid: no district is allowed either an increase or a decrease. If school districts had been capped at a 6.85 percent increase level, as in the previous year, 297 districts would have benefited, receiving an aggregate increase of $184 million. The save-harmless protection in the transition adjustment results in payments of $160 million in

1995-96 to districts that otherwise would have lost aid under the formulas; note that this is roughly equivalent to the increase that would have been received under last year's cap.

In essence, the modified freeze of the formulas enacted with this year's budget took the path of least resistance. Both the Executive Budget and the legislatively enacted version failed completely to address the equity issue. This result, however, was a policy choice. Freezing the status quo is not the only possible response to living within limited resources.

It would have been possible, for example, to loosen the transition adjustment provisions and let the formula operate more freely. If other adjustments were made in the formula, this could have been accomplished without additional resources. The distribution of aid would have been more equalized, and the school districts at the highest levels of wealth and spending would not have received the highest relative increases.

Alternatives for Reform

Policy Options

There are essentially four major alternatives to pursue statewide school finance reform:

- greatly increasing state aid to help equalize resources — known as "leveling up,"
- redistributing the existing level of state aid — sometimes referred to as the "Robin Hood" approach, because aid is taken from the "rich" and given to the "poor,"
- finding alternative local revenue sources for schools (income and sales taxes, for example), and
- sharing property tax revenues, either regionally or statewide.

These options are listed separately in simplified fashion for discussion purposes, although in reality there are countless variations and mixtures of these basic approaches. The first two options deal only with changing the distribution of state aid; the latter two represent structural changes.

On a case-by-case basis, school district consolidations and shared services ventures represent yet another approach for achieving enhanced efficiency and tax base broadening. They are not discussed here, however, as they do not represent a statewide solution.

Leveling Up

The first option, significantly increasing state aid to provide infusions of new funds for low-wealth, low-spending or otherwise overburdened districts has been the favored approach over time among advocacy groups. Of course, even within this general approach, there is the question of how to distribute the additional aid (who gets how much). In fact, even when massive increases in aid are contemplated, it is very difficult to obtain consensus on a single formula approach.

But a large-scale increase is impractical from a state fiscal perspective at the current time. The only way such a change would be possible is through a corresponding increase in some state revenue source — an unlikely event given the current emphasis on state-level tax *cuts*.

Governor Carey in 1982 proposed a large increase in school aid funded through a one percent increase in the sales tax, but even under the threat of the then-pending *Levittown* case, his proposal was resoundingly rejected.

As part of the recent school finance reforms in Michigan, however, the state sales tax was increased from 4 to 6 percent, with the revenues earmarked for education. The reliance on local

property taxes was dramatically reduced, although not eliminated, and the state's share of education expenditures was increased to 80 percent. The Michigan reforms also included a series of local revenue limitations. In New York State, however, the combined state and local sales tax rate is already considered to be a problem in terms of interstate competitiveness. An increase in the sales tax may therefore not be a viable alternative here. It should also be noted that Michigan's education aid is partially funded through a *state* property tax.

Redistribution

Redistribution — increases for low-wealth, high-need districts funded by reductions in aid for relatively better off districts — is certainly *fiscally* feasible, but it has proved to be politically infeasible over time. The objections to reducing school aid for any district or group of districts are simply too strong.

Executive Budget proposals (prior to this year) have most often included some degree of redistribution, as have Regents proposals, but most such proposals have not been accepted by the Legislature. Repeated calls for redistribution during the *Levittown* period were ignored, even when it was widely believed that the State would probably lose the case. The only time aid has been significantly cut for any district was during the extreme fiscal difficulties in the early 1990's through the deficit reduction assessments (DRA's). These reductions were widespread and were in response to a fiscal crisis — they were not used to provide increases for other districts.

Beyond legislative achievability, there are other reasons for avoiding dramatic redistribution. Both the school aid formula and the data that feed into it are flawed and imprecise. The measurement of wealth and the formula mechanics have changed significantly over the years and removing aid on the basis of any one year's specific formula does not necessarily carry the strength of an absolute and compelling rationale behind it.

It must also be acknowledged that there are *many* different ways of redistributing aid (really, an infinite number). Each constituency — suburban districts, rural districts, small cities, big cities, property-rich, property-poor, high-cost, low-cost, etc. — naturally favors redistributional methods that are advantageous to it. The difficulty in gaining consensus on a redistributional aid plan is even greater than for leveling up.

Partly because of the practical difficulties involved in achieving a straightforward redistribution of aid, proposals for fundamental systemic change have gained in popularity lately. Although they may involve an even more dramatic redistribution of resources, often the redistributive impact is unknown or is less apparent.

Alternative Local Revenue Sources

Providing new methods for school districts to raise revenues locally is another approach to reform, although this approach is aimed more at reducing reliance on the property tax than toward reducing wealth-driven disparities in spending. These proposals have gained in popularity recently, in part because frustration with the property tax has become so great.

Local income taxes and sales taxes are most frequently mentioned as potentials and proposals often include a required reduction, freeze or elimination of existing local property taxes. They may also include a redistribution component, either by broadening the base for the new revenues beyond school district boundaries or by changing the distribution of state aid in concert with change in the tax base.

Among the issues to consider are whether a new tax should supplement or replace (either partially or completely) the local property tax for schools, whether the rate should be set locally or statewide, and how the tax should be imposed and administered. The programs can also be structured to be voluntary for school districts and/or their voters.

New local revenue options dramatically shift the proportions of tax burden carried by individuals and businesses as well as among taxpayers within a class. But the redistributional impact usually cannot be estimated precisely. In some ways, the redistribution may be less visible than a change in state aid formulas, where it is shown on a computer run as a gain or loss for each district.

Governor Cuomo proposed in 1993 that local school districts have the option of imposing an income tax surcharge, either individually or together with other school districts within a county. The Regents have also recently published a study on the substitution of local income taxes for property taxes. Other, less dramatic options in this category exist, such as allowing non-city school districts to levy consumer utility taxes, as city school districts now can.

It is important to consider the administrative feasibility of new local revenue options. Income and sales tax collections, for example, are quite volatile compared to local property taxes. While the local property tax base changes from year to year, it tends to change less dramatically than can occur in the income or sales tax bases. The property tax base is also essentially known before a rate is set, and so school districts can reliably predict the revenues that they will receive; this is not the case with income or sales taxes.

Changing the manner of raising local revenues may also have dramatic economic development impacts, both locally and statewide. It is questionable, for example, whether it would be advantageous to have a variety of local income tax practices (or, at least, rates) in areas all across the state. It also seems counterproductive to cut state income taxes and at the same time allow them to be raised locally.

It is also difficult to achieve popular approval for a new local revenue source. These proposals are often viewed negatively as a "new tax" even when the intent is to substitute a new revenue source for existing property tax revenues.

But perhaps the most important criticism, in the context of this discussion, is that switching to a new local tax base for schools will not necessarily reduce disparities in fiscal capacity and spending and may even worsen them. Income wealth, like property wealth, is unequally distributed among school districts, and the sales tax introduces even more complexities and potential inequities. *Unless combined with a base-broadening approach or a redistribution of state aid, providing new revenue sources will not solve the equity problem.*

Sharing Property Tax Revenues

Sharing property taxes represents a way of broadening the tax base for education without expanding the state share of funding or resorting to new local revenue sources.

There have been a number of proposals over the years to share property taxes regionally or statewide. These proposals have ranged from full state funding through a uniform statewide property tax to sharing a small tax (one or two mills) among all school districts within a region. Governor Cuomo's Moreland Act Commission recommended that nonresidential property taxes be shared regionally and the Regents have recently issued studies on regional tax base options.

The redistribution of existing local revenues, however, carries with it all the problems of redistributing state aid and is in some ways even more difficult to achieve — it can be perceived as a more invasive redistribution, taking money directly out of local coffers to send it elsewhere.

But the advantage of redistributing property taxes is that equity can be dramatically improved without additional state funds. Additionally, often the tax rates are very low in high-wealth districts because in such districts a high level of spending can be supported with only a low rate — a regional or statewide property tax therefore taps underutilized resources and helps to equalize tax effort.

Many options and levels of redistribution are possible within an expanded tax base approach. It would be possible, for example, to institute a uniform statewide property tax at the current average rate that would provide a uniform statewide basic expenditure level for all districts. Property-poor districts which currently cannot support even an average level of spending with an above-average tax rate would be greatly assisted. Local control could be maintained by allowing districts to levy an additional tax within the district if increased spending were desired. This approach could be adapted to a regional model, where regional average tax rates and spending were applied; this would account for the wide variations existing regionally in average spending and wealth levels. Any tax base sharing plan could also be implemented on a reduced level, to accommodate a less dramatic redistribution or a phase-in period. The sharing of even a small proportion of current property tax levels would greatly improve equity.

It should be noted, however, that although broadening the tax base almost by definition results in a more equalized distribution of resources, certain options in this class may not be equalizing. For example, the sharing of nonresidential property taxes among districts can redistribute resources from more urbanized lower-income areas to wealthier bedroom suburbs, where commercial development may be intentionally kept out. The Regents study paper on this topic demonstrated that the sharing of nonresidential property taxes, unless accompanied by a highly equalized redistribution of aid, would *increase* variations in spending.

Summary

School finance reform has been a topic of some controversy in New York State almost continuously since the 1960's. A series of special commissions, task forces and other groups have taken up the issue and produced voluminous reports. And yet, there is still no consensus over basic issues.

It is also clear that the State as a whole has been unwilling to redistribute resources, even during periods of relative fiscal abundance. And several decades of studies have shown that there is no overlooked formula change or "magic bullet" which can remove the necessity of making hard choices — real reform cannot be achieved without them.

The current dialogue in school finance reform is taking place in an environment where it is obvious that large-scale state aid increases will not be possible. It may also be true that *no increases* or, perhaps, *big decreases* will be necessary in order to fund the growing impact of state-level tax cuts. This is, in fact, one of the critical issues which should have been better evaluated as this year's multiyear tax changes were discussed, but which was not because of the lack of real long-term planning in the budget process.

If a large increase is impossible and consensus cannot be reached on a significant reallocation of state resources, then other changes to the system must be considered. Frustration with the current system, however, should not be allowed to force unwise policy decisions that do not solve the existing problems or create even greater new problems.

Despite the difficulties in changing the system and the State's current financial condition, the problem should not be ignored, as it was in this year's budget. To do so would not only be devastating to the lower-wealth districts, it may also create several long-term financial risks. The State's long-term economic prospects are closely linked to the performance of its educational system as a whole, including areas in need of additional resources. And the current court case on school finances raises equity issues which should be addressed in any event, but if the case were to result in a court-ordered solution, it is quite possible that such a solution would be fiscally devastating to the State, as has happened elsewhere. Increasing equity in advance of any court decision would help to lessen this risk.

Appendix — Statistical Supplement

This appendix presents two tables with school district data. The first table, "Background School District Data," lists most of the data that is summarized in charts presented in this report. Data elements are presented for districts grouped by wealth and spending, as well as statewide totals; a short description of each data element is also included.

The second table, "School District Profiles: Region and Type Categories," is intended to provide a basic statistical background on various groups of school districts. The data is provided for groups of school districts used by the State Education Department, including divisions by type (large city, small city, suburban, rural) and by geographic division (upstate, downstate). This data describes some of the basic differences in wealth, spending and other factors for districts across the state.

This report was designed to provide a *basic* discussion of school aid finance issues and alternatives, and as such, it has left out a great deal of detail. A number of studies and annual publications are available for those interested in this topic in greater detail, including the following:

Study on the Generation of Revenues for Education, Final Report, New York State Board of Regents (February, 1995): The final product of the Board of Regents Study Group on the Generation of Revenues for Education. It includes a variety of papers on property tax issues and on alternatives for revenue generation and a summary of the policy options available.

Analysis of School Finances in New York State School Districts 1992-93, State Education Department (November, 1994): An annual report presenting trend data on school finances.

Sixth Annual School District Fiscal Profile Report, 1988-89 -- 1992-93 School Years, State Education Department (June, 1995): An annual report presenting statistical data on school districts by region and type.

State Formula Aids and Entitlements for Schools in New York State 1994-95, State Education Department (July, 1994): An annual report describing the various types of state aid available to school districts, including an algebraic description of the formulas.

Putting Children First, New York State Special Commission on Educational Structure, Policies and Practices (December, 1993): The report (in four volumes) of Governor Cuomo's Moreland Act Commission; includes recommendations and background research papers.

Funding for Fairness, The New York State Temporary State Commission on the Distribution of State Aid to Local School Districts (December 1988): Report of the "Salerno Commission," with recommendations for reform of the school aid formulas, many of which were reflected in the 1993-94 formula changes.

BACKGROUND SCHOOL DISTRICT DATA

	Wealth Ratios			Spending per		% of Total	Tax Rate	% State-	State Aid Per	1995-96 Total State Aid	Year-to-Year Change	
	Property	Income	Combined	Pupil	Enrollment	Enrlimt.	(mills)	Funded	Pupil	(computerized)	Amount	Percent
State totals/averages	1.000	1.000	1.000	6,471	2,749,830	100.0%	15.34	37.8%	3,356	9,228,393,262	86,901,854	1.0%
School Districts sorted by Wealth (Combined Wealth Ratio):												
Deciles:												
1st (wealthiest)	5.458	2.432	3.945	11,148	104,701	3.8%	11.27	7.6%	1,069	111,942,174	2,928,667	2.7%
2nd	1.998	1.381	1.689	8,287	170,506	6.2%	15.49	14.5%	1,649	281,127,834	6,933,508	2.5%
3rd	1.330	1.167	1.248	7,113	259,711	9.4%	17.58	24.1%	2,369	615,276,124	8,373,670	1.4%
4th	1.058	0.915	0.986	6,336	1,238,209	45.0%	16.58	34.5%	3,085	3,820,137,064	27,758,044	0.7%
5th	0.881	0.770	0.824	6,037	217,101	7.9%	16.27	42.8%	3,761	816,483,802	6,248,843	0.8%
6th	0.700	0.687	0.693	5,567	195,061	7.1%	16.14	51.3%	4,134	806,427,623	8,252,052	1.0%
7th	0.574	0.601	0.587	5,349	189,391	6.9%	15.93	57.0%	4,578	867,011,066	2,821,070	0.3%
8th	0.507	0.522	0.514	5,116	188,457	6.9%	15.45	62.5%	4,844	912,840,264	11,792,893	1.3%
9th	0.429	0.459	0.443	4,891	103,442	3.8%	14.29	67.3%	5,090	526,507,071	6,475,637	1.2%
10th (poorest)	0.336	0.372	0.353	4,855	83,251	3.0%	14.42	72.1%	5,653	470,640,240	5,317,470	1.1%
School Districts sorted by Spending Per Pupil:												
Deciles:												
1st (highest)	5.110	2.356	3.732	11,465	118,220	4.3%	12.86	8.4%	1,280	151,321,602	4,478,466	3.0%
2nd	1.943	1.481	1.711	8,550	216,366	7.9%	17.30	18.1%	2,414	522,202,051	12,127,820	2.4%
3rd	1.329	1.003	1.165	7,359	249,588	9.1%	17.38	28.4%	3,131	781,335,326	6,263,253	0.8%
4th	1.157	0.838	0.997	6,406	191,809	7.0%	16.01	36.5%	3,063	587,498,550	4,705,414	0.8%
5th	0.834	0.775	0.804	5,870	236,502	8.6%	16.44	44.2%	3,722	880,143,902	5,632,541	0.6%
6th	0.750	0.705	0.727	5,540	231,572	8.4%	16.06	50.3%	4,071	942,733,165	14,813,692	1.6%
7th	0.648	0.596	0.621	5,282	1,146,595	41.7%	15.22	56.5%	3,222	3,694,043,962	27,568,665	0.8%
8th	0.581	0.573	0.576	5,043	133,756	4.9%	14.94	59.0%	4,418	590,905,864	2,060,765	0.3%
9th	0.479	0.507	0.492	4,790	126,437	4.6%	14.36	64.3%	4,694	593,486,176	4,064,171	0.7%
10th (lowest)	0.442	0.471	0.455	4,397	98,985	3.6%	12.83	68.5%	4,897	484,722,664	5,187,067	1.1%

Description of Data Elements

The data shown here is from the State Education Department's database as of 6/7/95; this database was used to produce the enacted budget's school aid computer run. Most of the charts presented in the narrative portion of the report are based on this data.

The first line shows the state total, or average for each item. The data below shows information for district deciles grouped by wealth and spending. Each decile includes 1/10th of the state's 688 school districts; the share of pupils within a wealth or spending decile varies widely (see % of total enrollment). The figures shown for each decile are the arithmetic mean with the exception of the enrollment and state aid data (including total, year-to-year change and aid per pupil).

Wealth Ratios: these are the wealth measures used to apportion 1995-96 school aid for property, income and the combination of the two. Each ratio shows the relationship of the district (or decile) to the state average wealth. A ratio of 2, for example implies wealth per pupil of twice the state average; a ratio of 0.5 means wealth is one-half the state average. The combined ratio is used for most state aid and is also the measure used to rank the districts in this analysis.

Spending per Pupil: 1994-95 approved operating expenditures (AOE) per total aidable pupil unit (TAPU) for expense; this is the standard measure of school district spending used in expenditure analyses and in state aid payments. The state average shown is the arithmetic mean for districts; the statewide total spending per pupil is much lower because there are more pupils in lower-spending districts, particularly the large cities.

Enrollment: 1994-95 school year estimated enrollment.

% of Total Enrollment: this shows the percentage of statewide enrollment that is contained within each decile.

Tax Rate (mills): This is an estimate of the effective full value tax rate in 1994-95, it includes property and nonproperty levies divided by selected full value. A millage rate is expressed as dollars of taxes per thousand dollars of property value. The state average shown is the district arithmetic mean.

% State Funded: this measure is shown to give an approximate indicator of the share of local spending financed by state aid; it is based on available data and does not match the overall state share data published by the State Education Deparment. The percentage shown is based on 1995-96 computer run aid plus aid for small city school districts divided by 1994-95 estimated total general fund expense and special aid fund expense. The state total shown is the aggregate share.

State Aid per Pupil: The 1995-96 computer run aid total divided by 1994-95 Enrollment; the amounts shown are totals, not district means.

1995-96 Total State Aid (computerized): as shown on State Education Department computer runs of 6/7/95.

Year-to-Year Change: the change in aid in amount and percent for the state and each decile; the amounts are totals, not district means.

SCHOOL DISTRICT PROFILES: REGION & TYPE CATEGORIES

District Class	# of Districts	Wealth Ratios Property	Income	Combined	Tax Rate (mills)	Spending per pupil	% State-Funded 1994-95	Attendance Ratio	1994-95 Enrollment	Average Size in Enrollment	Percentage of Statewide: Enrollment	State Aid	Spending	1995-96 State Aid Per Enr Pupil
Statewide	688	1.000	1.000	1.000	15.34	6,471	37.8%	94.80%	2,749,830	3,997	100.0%	100.0%	100.0%	3,356
New York City	1	0.973	1.021	0.996	12.40	5,163	38.4%	85.27%	1,021,379	1,021,379	37.1%	34.3%	33.7%	3,104
"Big 4" Cities	4	0.681	0.727	0.704	19.17	5,893	42.3%	89.41%	125,905	31,476	4.6%	5.7%	4.8%	4,201
Downstate Small Cities	7	1.689	1.959	1.823	17.53	8,950	22.3%	93.10%	36,043	5,149	1.3%	0.8%	1.8%	2,010
Upstate Small Cities	50	0.652	0.690	0.670	16.17	5,575	52.5%	93.73%	221,273	4,425	8.0%	9.5%	7.6%	3,958
Downstate Suburbs	169	2.735	1.712	2.223	16.80	9,173	18.2%	94.64%	521,702	3,087	19.0%	15.2%	24.7%	2,694
Upstate Suburbs	273	0.862	0.754	0.807	15.89	5,555	49.3%	95.12%	617,106	2,260	22.4%	24.0%	20.4%	3,593
"Rural"	184	0.914	0.506	0.709	12.80	5,515	56.2%	94.99%	206,422	1,122	7.5%	10.4%	7.0%	4,643

Description

This data is intended to provide a basic statistical portrait of differences in wealth, spending, state aid and other factors for different groups of districts. Descriptions of the data elements presented here are provided in the Background School District Data table in this appendix.

The regional groups shown are those used by the State Education Department in their annual school district profile report. "Downstate" counties are Nassau, Suffolk, Westchester, Rockland and Putnam; all others are "upstate." "Rural" districts are noncity districts in counties not classified as metropolitan statistical areas (MSA's) by the Census Bureau.